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FEDERAL RESERVE BANK OF NEW YORK



ANNUAL REPORT 1974



FEDERAL RESERVE BANK OF NEW YORK

February 19, 1975

To the Member Banks in the
Second Federal Reserve District

I am pleased to present our sixtieth Annual Report, reviewing major economic and financial developments and this Bank's operations in 1974.

This country experienced economic strains of exceptional severity during the past year. Despite a moderation in aggregate demand, virulent inflation persisted, exacerbated by the fourfold increase in the price of petroleum imposed by the major oil-exporting nations. Consumer and business confidence sagged as inflation reduced real incomes, and a pervasive contraction in economic activity developed in the final months of the year. Pressure on the domestic financial system was a source of deep concern and, over the summer, the Federal Reserve was called upon to help prevent a major bank failure from having significant consequences throughout the economy.

Like the United States, most countries abroad were beset by serious economic difficulties stemming in part from the rise in the price of oil. In a number of countries, increased oil payments were added to trade deficits that were already large. While these enlarged deficits were financed without undue strain, there was a worrisome increase in the burden of external debt for some countries. Moreover, confidence in the international banking system weakened, foreign exchange transactions were sharply curtailed for a time, and lending by Euro-banks slackened significantly in the second half of the year.

Economic policy makers face a very difficult environment in 1975. A strengthening of international financial cooperation is clearly required. The industrial countries must also make major efforts to reduce the payments imbalance by conserving energy and developing alternative energy supplies and by expanding exports to the oil-producing countries. In this country, we must attempt to arrest the marked rise in unemployment and to lay the groundwork for a resumption of sustained economic growth. At the same time, we must be careful to avoid overly stimulative policies which could add ultimately to the costs of achieving a reasonable degree of price stability. Striking the proper balance in pursuing these objectives is no easy task.

A handwritten signature in cursive script, reading "Alfred Hayes", is positioned above the printed name.

ALFRED HAYES
President

*Federal Reserve Bank
of New York*

**SIXTIETH
ANNUAL REPORT**

*For the Year
Ended
December 31, 1974*



Second Federal Reserve District

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The Economy in 1974

A combination of severe, and in some respects unprecedented, economic strains caused deep concern throughout much of the industrialized world in 1974. Inflation of great severity continued during the year. At the same time, economic activity slackened in many industrial countries, and in the United States a recession developed. Both inflation and emerging recessionary tendencies were strongly influenced early in the year by the oil embargo, but the fourfold increase in the price of petroleum imposed by the major oil-exporting nations proved of more enduring importance. This development directly exacerbated inflation and, at the same time, dampened economic expansion both by significantly reducing purchasing power in the industrial countries and by exerting major strains on world financial markets.

The United States shared many of the economic woes which beset the rest of the world. The effects of demand pressures dating from the mid-1960's combined with special developments, including the rise in oil prices, to generate in 1974 an inflation of unprecedented severity for a peacetime period. A much-needed cooling of the economy emerged, but was magnified by the strains of inflation on both business and consumer psychology and on financial markets. Liquidity pressures mounted and, in the final months of the year, a very painful contraction of economic activity developed. While there were some encouraging straws in the wind at the year-end, significant progress against inflation was by no means assured. Overall, recent experience confirmed that the longer inflation is allowed to run unchecked, the greater are the distortions built into the economy and the more difficult and painful it is to bring inflation under control. In

looking ahead to 1975, it was clear that economic policy makers faced an exceptionally difficult set of circumstances.

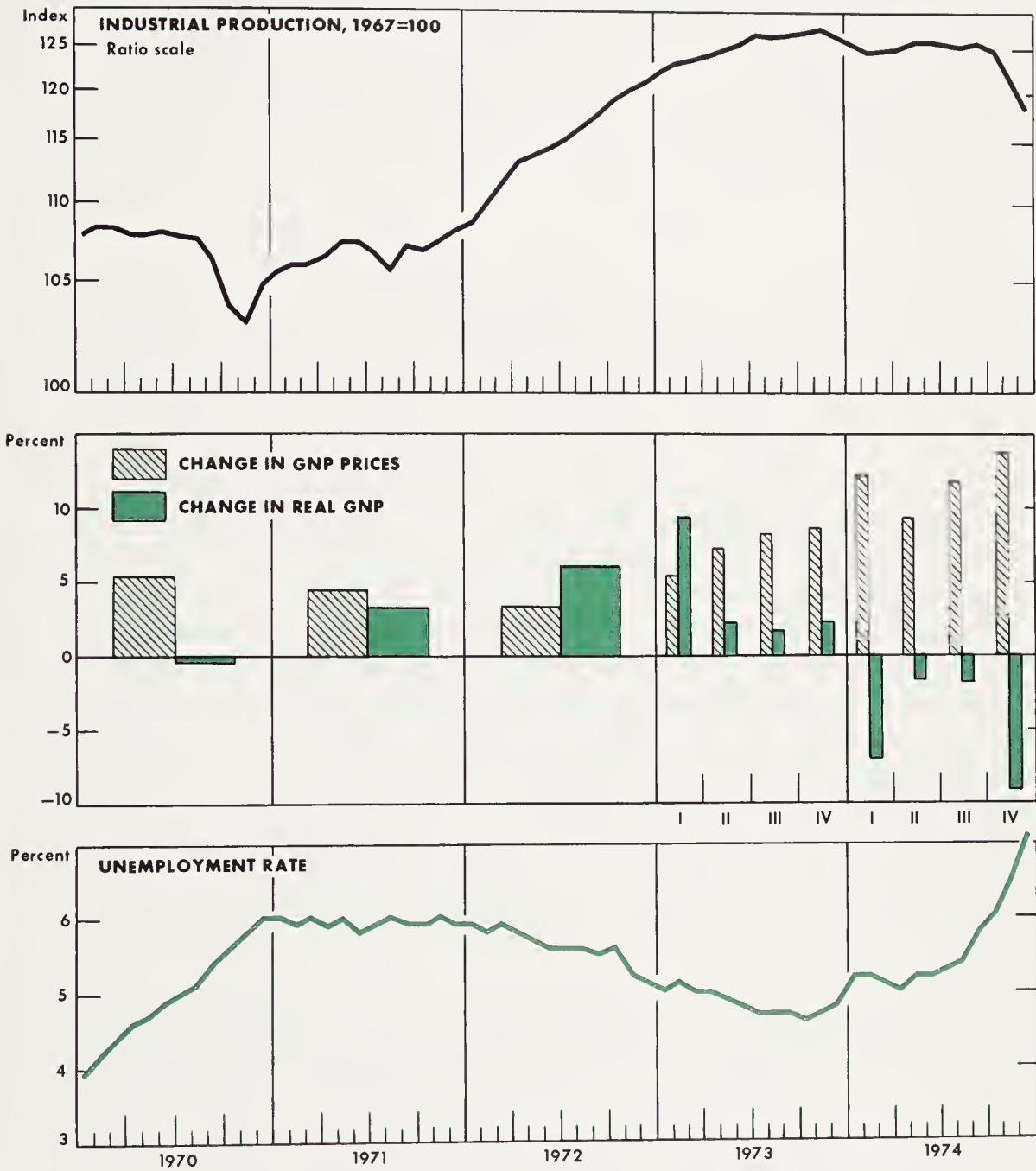
Largely as a result of the energy shortage, weakness had emerged in the domestic economy early in the year. Real gross national product (GNP) declined sharply in the first quarter and moved down slightly further during the spring and summer months. However, industrial production recovered a bit over this period and employment also increased. It was not until the final months of the year that a classic recessionary pattern, including substantial declines in industrial output and sharply rising unemployment, set in (see Chart 1). The downturn was accompanied by increasing public concern about the economic situation, as evidenced by the depressed state of consumer and business confidence and by the further slump in the stock market.

Conditions in the labor market were reasonably stable over the first two thirds of the year, as employment increased modestly and the unemployment rate advanced only slightly from the level established in January. However, the final months of 1974 witnessed a sharp deterioration. Unemployment climbed to 7.1 percent of the civilian labor force in December, primarily as a result of a surge in job layoffs. Some sectors of the economy, notably manufacturing and construction, were particularly affected.

While the symptoms of economic contraction began to become pronounced and general only relatively late in 1974, inflation was an acute problem throughout the period. Indeed, inflation was far worse than it had been in the preceding year. It is difficult, however, to provide a wholly adequate explanation for the full extent of price inflation. Certainly, past demand pressures stemming from overly stimulative policies were in part responsible. Over the past ten years or so, the Federal budget was frequently in deficit by a substantial amount, and fiscal policy was overly expansive much of the time. This fiscal policy posture added directly to demands for goods and services during a period when the productive capacity of the economy was often strained. Moreover, stimulative fiscal policy requiring deficit financing put upward pressure on interest rates. To the extent that the Federal Reserve resisted this pressure, the large deficits served to encourage excessive monetary expansion. And, apart from fiscal influences, monetary policy was rather too expansionary in 1972. Other developments, namely, the fuel and food supply shortages and the depreciation of the dollar, also contributed materially to the recent inflation.

Experience suggests that the influence of demand pressures tends to work its way through the price system over an extended period, as labor and other

Chart 1. PRODUCTION, PRICES, AND UNEMPLOYMENT IN THE UNITED STATES



All data are seasonally adjusted. Quarterly gross national product (GNP) numbers are at an annual rate.

costs as well as price expectations respond only gradually to demand conditions. This explains, at least in part, why prices can continue to rise rapidly for a time during periods of slack demand, as they did during the 1969-70 recession and in 1974. The tardiness with which inflation has tended to respond to the removal of demand pressures and, more broadly, the severe overall acceleration of inflation over the past decade have focused increasing attention on the ability of aggregate demand policies to lower, by themselves, the long-run average level of unemployment.

In light of our recent experience, the notion that unemployment can be permanently reduced below some specified minimum simply by expanding aggregate demand appears to be seriously misleading. To be sure, if unemployment is abnormally high, the judicious application of stimulative policies can help to reduce unemployment to more moderate levels with little adverse effect on inflation. Beyond a certain point, however, one that seems to be dictated largely by the structural characteristics of labor markets, attempts to reduce unemployment in this fashion require larger and larger doses of stimulus. Thus, a progressively more rapid inflation is required to achieve given effects on unemployment. It is quite clear that, if this process is pushed far enough, the results could be disastrous.

Much of the longer run unemployment problem in this country appears to be of a structural nature; that is, the problem is rooted in the relative frequency and high incidence of joblessness among particular groups in the work force. Women, young people, and members of minority groups bear a disproportionately large share of total unemployment, in periods of excessive aggregate demand as well as in periods of slack overall activity. Workers in these groups have special difficulties in finding jobs and tend to change jobs frequently. To a considerable extent, this experience reflects the unavailability to many of these workers of jobs offering high wages, good working conditions, job security, and opportunities for advancement.

Given this situation, the only way permanently to reduce the levels of unemployment compatible with price stability appears to lie in measures that deal directly with the structural problem. There are several proposals along these lines that merit serious consideration. Expanded government employment services, by publicizing job opportunities, might greatly facilitate the matching of available jobs and workers and thereby reduce the average duration of unemployment. Improved and expanded manpower training programs that would give marginal workers the skills needed in our complex economy could play a

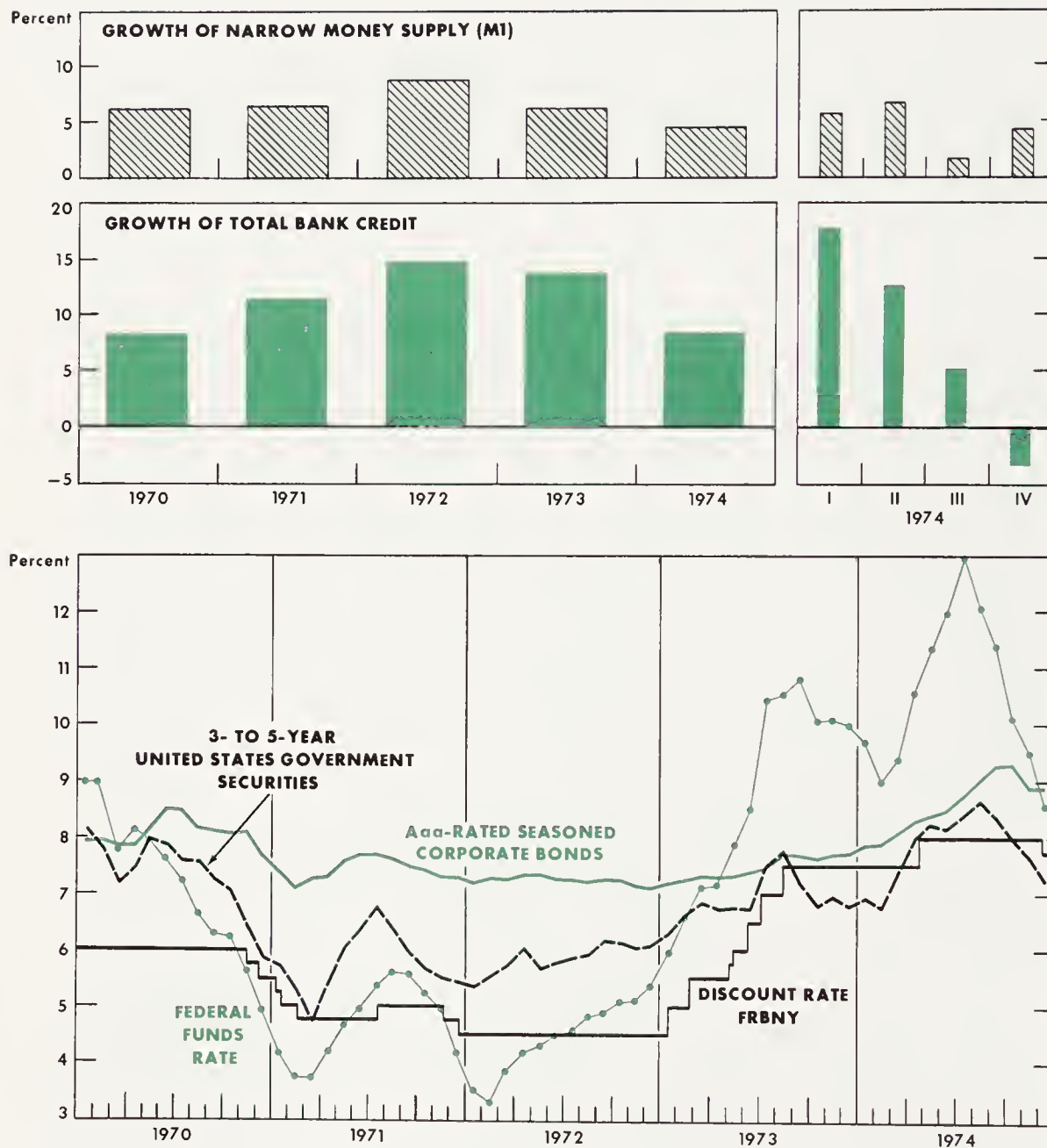
major role. Modification of the minimum wage laws that apply to young workers could prove beneficial by making it more economical for firms to hire and train such workers. These proposals offer at least some promise that the relatively high long-run average unemployment rate that has characterized the United States economy can be reduced. At the same time, temporary programs—such as public service employment and expanded unemployment compensation—are helpful in cushioning the special hardships associated with abnormally high unemployment in the private sector during periods of cyclical weakness.

MONETARY POLICY IN 1974. As a general strategy over much of 1974, the Federal Reserve sought a further gradual reduction in the rate of growth of the monetary aggregates, since a slowing of monetary expansion is essential in the longer run if a reasonable degree of price stability is to be restored. At the same time, the monetary authorities were fully aware that an abrupt slowing in monetary growth was not desirable. Indeed, the determination of the authorities to avoid a protracted period of little or no growth in money should help to prevent the development of severe economic difficulties.

Open market operations were the primary instrument used in 1974 to moderate the rate of monetary expansion. The discount rate, which had been raised seven times in 1973, was increased to a record 8 percent in April but was subsequently lowered to 7¾ percent by the end of 1974. Member bank borrowings from the discount window surged over the summer, but this represented in large part emergency Federal Reserve Bank of New York lending to the troubled Franklin National Bank. In this matter, as in the commercial paper market crisis following the Penn Central bankruptcy of 1970, credit assistance provided by the Federal Reserve helped to prevent a major failure from having serious impact on the functioning of the financial system.

The growth of the money and credit aggregates slowed further in 1974. Over the twelve months ended in December, the narrow money supply rose 4.5 percent, down from 6.1 percent in 1973. Similarly, growth in the broad money supply dropped 1.5 percentage points in 1974 to 7.3 percent, while total bank credit rose by 8.1 percent, down 5.4 percentage points from 1973. Historically high interest rates did prevail for a time during the year, but this should not be interpreted as a sign of exceptionally restrictive policy. The high rates experienced were to a considerable extent one of the effects of the virulent inflation which dominated the economic environment, as rapidly rising prices

Chart 2. MONEY, BANK CREDIT, AND INTEREST RATES



The money supply growth rates are computed from daily average levels in the final month of the preceding period and the final month of the period covered. Changes in bank credit include loan sales to affiliates and are based on levels as of the close of the period covered and the close of the preceding period. Quarterly figures for 1974 are expressed at seasonally adjusted annual rates. Rates for Federal funds, three- to five-year United States Government securities, and seasoned Aaa-rated corporate bonds are monthly averages of daily figures.

increased the interest rates lenders demanded and borrowers were willing to pay on obligations fixed in dollar terms. In any case, the Federal Reserve did not seek any particular level of interest rates as an ultimate objective of policy; its general strategy of a gradual slowing in the aggregates allowed for a substantial degree of interest rate flexibility, permitting the System to respond to emerging economic and financial developments.

As 1974 began, the Federal Open Market Committee (FOMC) was concerned about the curtailment of oil supplies and the resultant weakening of economic activity. At the FOMC meeting of December 1973, the Committee majority concluded that the economic situation and outlook called for some easing in bank reserve and money market conditions, provided that the monetary aggregates did not appear to be growing excessively. Similarly, at the first meeting in 1974, a majority of the FOMC voted for a further modest easing in reserve and money market conditions. In addition, the majority favored raising slightly the longer run target for growth in the narrow money stock.

This Bank's President dissented from the decisions taken at the December and January meetings. At the December meeting, he favored a continuation of the prevailing degree of monetary restraint unless signs of weakening in the economy became more apparent and pervasive. He pointed out that the problems of inflation were increasing rather than abating and that the monetary aggregates had grown more rapidly in 1973 than the Committee had considered desirable. He believed that, while there was not much that monetary policy could do to relieve the economic problems arising from the oil shortage, a premature easing of policy could exacerbate the problems of inflation. At the January meeting, this Bank's President expressed opposition to raising the M_1 growth target and to adopting a range of tolerance for the Federal funds rate which implied further reductions in that rate. He expressed the view that strong inflationary pressures remained the major economic problem.

In accordance with the Committee's decisions, some easing in bank reserve and money market conditions was achieved early in 1974. Short-term interest rates fell appreciably following the January meeting, in large part because money market conditions had eased but also, apparently, because market participants expected them to ease further. As it turned out, there was almost universal miscalculation of the likely course of interest rates early in the year. While the narrow money stock contracted in January, substantial growth resumed in February and continued through the first half of the year (see Chart 2). At the same time, bank credit expanded rapidly, led by a very large runup in business

loans, and banks bid aggressively for large-denomination certificates of deposit (CDs) to meet the loan demand. Beginning with the March FOMC meeting, the Committee resisted these developments by seeking bank reserve and money market conditions that would moderate growth in the monetary aggregates over the months ahead. This policy stance was essentially maintained through mid-September. As the System worked to achieve its aggregates targets, the modest downdrift of the Federal funds rate was reversed, and the rate climbed steadily through July. In late April, the Federal Reserve discount rate was raised $\frac{1}{2}$ percentage point to a record 8 percent. The commercial bank prime lending rate, which had declined early in the year, began to advance in March and reached 12 percent at most major banks in July.

The high and rapidly rising interest rate levels experienced during the spring and summer were accompanied from time to time by the buildup of considerable tension in the financial markets. This tension was manifested in a variety of ways. Yield spreads between high- and lower quality securities widened, in part because of the uneasiness that developed as a result of the problems experienced by the Franklin National Bank and of reports that some other institutions might also be encountering difficulties. In some cases, the creditworthiness of entire industries—such as the real estate investment trusts and the electric utilities—was called into question. The renewed emphasis on high quality in the commercial paper and capital markets meant that many borrowers had to draw upon long-standing lines of credit at commercial banks, thereby transmitting the liquidity strains to the banking system. At times, pressure in the money market became intense, making short-run control of the Federal funds rate difficult and resulting in exceptionally high levels of the funds rate in early July. The Federal Reserve was deeply concerned about the emerging liquidity difficulties and the general fragility of the financial markets over this period and, indeed, remained so over the balance of the year.

Growth of the narrow money stock slowed significantly in the third quarter of the year, and signs of moderation in business borrowing from commercial banks appeared during that period as well. In early September, the Board of Governors of the Federal Reserve System announced the removal of the 3 percent marginal reserve requirement on large-denomination CDs and related instruments maturing in four months or more. Shortly thereafter at the September FOMC meeting, a majority of the Committee decided to increase modestly the longer run targets for growth in the monetary aggregates and to permit the Federal funds rate to decline gradually from the $11\frac{3}{4}$ percent level prevailing.

The President of this Bank dissented from these actions. In so doing, he observed that inflation and inflationary expectations continued unabated.

At the October meeting, the Committee voted to seek a "resumption of moderate growth in the monetary aggregates". This action was taken because the aggregates had grown less than desired and expected during the summer, as they often do over periods of only a few months; hence, the basic policy strategy was not changed by this decision. Given the overrun in monetary expansion that occurred over the first half of the year, the shortfall during the summer was not considered too serious at the time, but it was important to take steps to ensure that it would not persist, especially in view of the marked weakening in the economic outlook. In any event, in keeping with this objective, pressure on bank reserve positions was moderated somewhat. The Federal funds rate, which had eased a bit in September, continued to decline over the balance of the year. Other short-term interest rates generally followed suit, and long-term rates moved lower. These developments were accompanied by some relaxation of tensions in the financial markets. On December 6, the Board of Governors approved a $\frac{1}{4}$ percentage point reduction in the discount rate at this and another Reserve Bank. The new $7\frac{3}{4}$ percent discount rate became effective December 9, and the remaining ten Reserve Banks joined in this action shortly thereafter. The Board announced that this action was taken in view of lower money market rates and the slackening in the demand for credit.

Although there were frequent changes in short-run operating tactics during 1974, the Federal Reserve for the most part adhered to the basic posture of moderate growth of the aggregates. This policy was in many respects a continuation of that pursued in 1973. The rate of expansion of the aggregates did decline in each of these two years, and aggregate demand pressures in the economy eased substantially. The foundation for a gradual slowing in inflation thus appeared to have been established.

THE INTERNATIONAL ECONOMY UNDER STRAIN. Like the United States, most countries suffered serious economic strains during 1974. Almost everywhere, the rates of inflation accelerated even as the expansion of real economic activity slowed from the abnormally rapid pace of the previous two years. The task of bringing national economies back to a path of sustainable growth without inflation, difficult enough in the best of circumstances, was greatly complicated by the quadrupling of the price of crude oil. The oil price increase also resulted

in an unprecedentedly large and rapid deterioration in the trade balances of oil-consuming countries in favor of the oil exporters. Although the oil consumers' deficits were successfully financed in 1974, the increase in the burden of external debt for some countries was cause for deep concern. By the year-end, a consensus was developing that prompt and concerted official efforts were required to assure not only that necessary financing would be available but that the huge international disequilibrium would be corrected.

Oil developments transformed the international economy during 1974. Despite the price increase and the embargo, the volume of oil exports by the members of the Organization of Petroleum Exporting Countries (OPEC) remained almost as high in 1974 as in the year before. Thus, OPEC oil receipts totaled nearly \$100 billion in 1974, roughly four times that of a year earlier. A substantial proportion of these payments went to sparsely populated countries whose capacity to absorb imports was low. Even among the oil producers that had relatively large populations and potentially great needs for industrial products, receipts from oil exports could not be quickly translated into increased import demand because of the lengthy time required to formulate development and other spending programs, to decide on appropriate suppliers, and to negotiate contracts. Although OPEC imports were rising rapidly in the latter part of 1974, more than half of the total payments for oil was returned to the consuming countries, not as demand for goods and services, but as investments in various types of financial assets.

Difficulties caused by the oil price increase were superimposed on problems that the major industrial countries had inherited from previous years. In 1972 and 1973, real GNP had grown at unsustainably rapid rates. Pressures on productive capacity, especially for scarce raw materials, combined with crop failures, strikes, and commodity speculation had by mid-1973 pushed international commodity prices far above the levels of a year earlier. In this inflationary environment, the authorities—sometimes promptly, elsewhere with a lag—brought fiscal and monetary policy into play to curb excess demand. By the latter part of 1973 and early 1974, the growth of monetary aggregates in the main industrial countries had been reduced substantially from the very high rates that had previously prevailed.

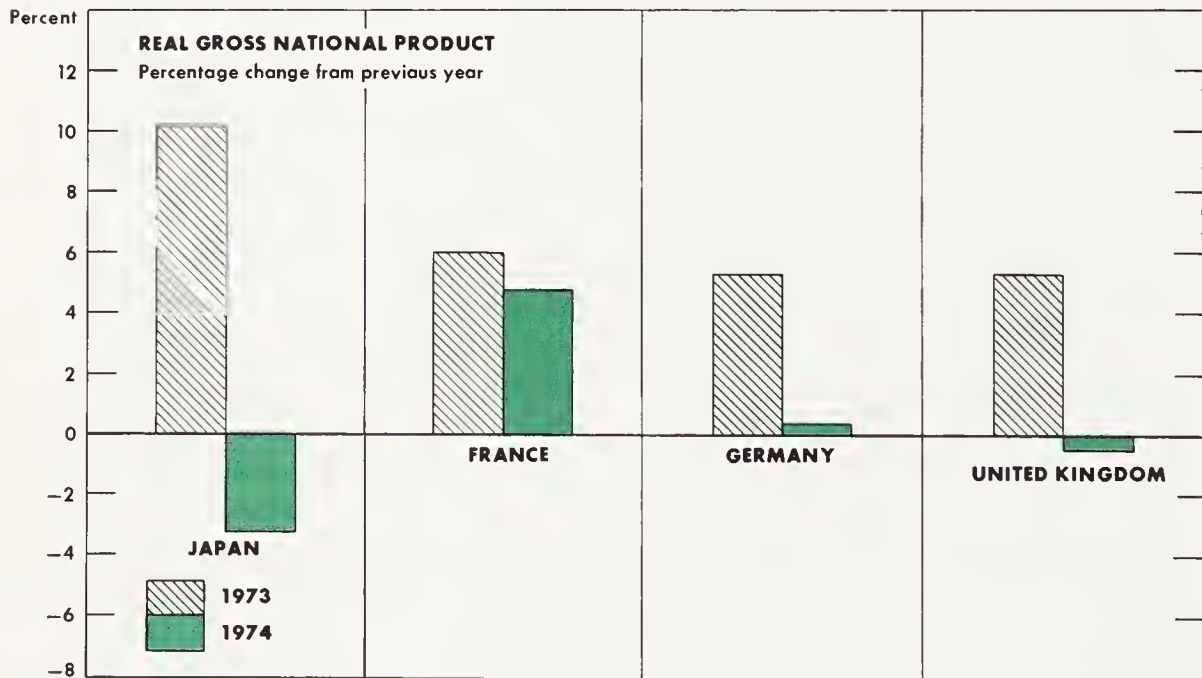
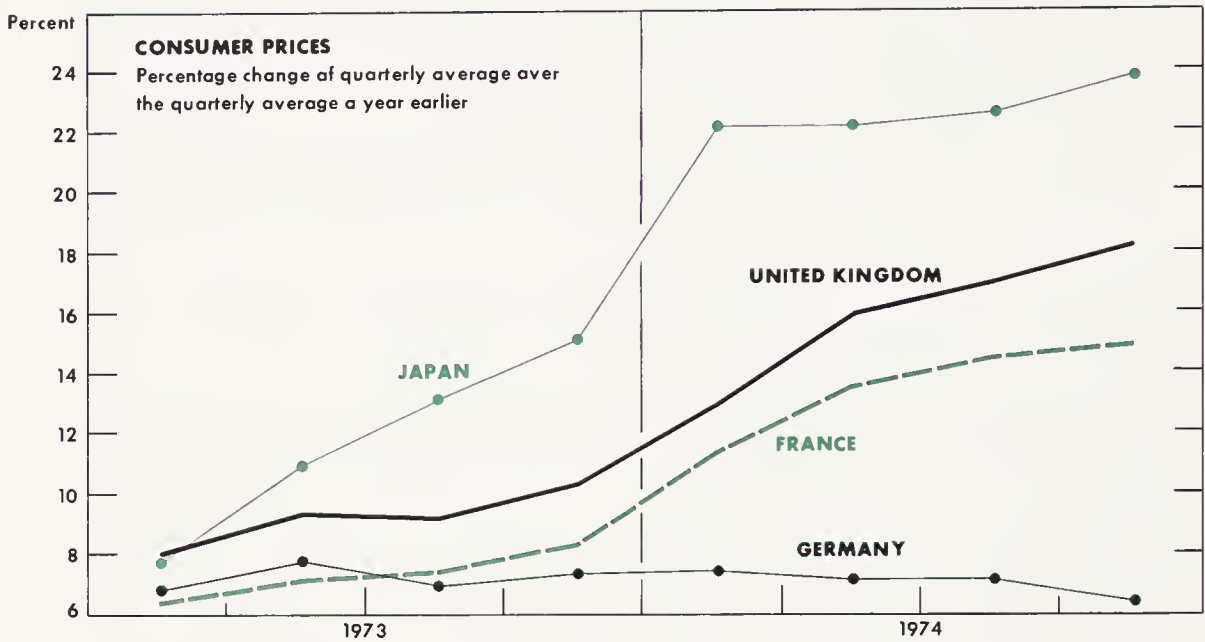
With official policy directed toward the elimination of excess demand, real growth among the industrial countries was already expected to slow significantly in 1974. The oil embargo and price increase worsened the outlook at the beginning of the year. Even so, real GNP continued to grow in 1974 in most in-

dustrial countries abroad, though at a much slower rate than during the year before. True, in Japan, where inflation was especially severe, real GNP actually dropped significantly for the first time since World War II (see Chart 3). In Britain, prolonged strikes and the adoption of a three-day week during the winter depressed real output, but some recovery developed in the spring and summer. Among the continental European countries, the performance was more favorable, with the expansion of real GNP in 1974 ranging from a low of under 1 percent in Germany to a high of almost 5 percent in France. In most industrial countries, however, growth slackened further as the year progressed and, with unemployment at its highest levels in many years, some governments moved cautiously to stimulate spending.

Official caution in attempting to counter the slowing of growth stemmed from the continuing virulence of inflation. True, prices of industrial materials did drop from the astronomical heights attained in the spring of 1974 but remained well above their levels at the beginning of the boom in 1972. Moreover, agricultural prices, boosted by sustained strong demand and disappointing harvests of some key crops, continued to rise. As high wholesale prices worked through to the retail level, the increase in consumer prices accelerated almost everywhere. In the final months of 1974, the rise in consumer prices above a year earlier ranged from 11 percent in the Netherlands to well over 20 percent in Italy and Japan. The major exception was Germany, where the advance in consumer prices from a year earlier slowed perceptibly in the final quarter to 6 percent.

While the strains of shifting to a lower growth path were familiar, those that arose from the quadrupling of oil prices were unprecedented. The oil price increase was the more serious both because of the widely differing dependency of consuming countries on imported oil and because increased oil payments were superimposed in several industrial countries on trade balances that were already heavily in deficit. Almost three quarters of the estimated \$75 billion increase in oil imports from OPEC members in 1974 was concentrated in the countries affiliated with the Organization for Economic Cooperation and Development (OECD). Among these, the hardest hit were Britain, France, Italy, and Japan, whose aggregate current-account deficits seemed likely, according to OECD estimates, to total about \$30 billion in 1974, a deterioration of \$23 billion from a year earlier. Although Germany's oil imports also jumped sharply, the continued expansion of its exports was even larger. Consequently, Germany's current-account surplus in 1974 rose substantially above the record set during the previous year (see Chart 4).

Chart 3. CHANGES IN CONSUMER PRICES AND PRODUCTION FOR SELECTED COUNTRIES



Estimates of real GNP for 1974 are preliminary.

The United States balance of payments on current-account withstood the shock of the oil price increase fairly well. To be sure, United States petroleum imports increased to almost \$25 billion in 1974, \$17 billion more than the year before, but this increase, the largest of any country, was mostly offset by a sustained rise in American exports. Benefiting from earlier devaluations of the dollar, exports of manufactured goods were especially strong. Rising foreign demand also pushed United States agricultural exports substantially above the peaks attained in 1973. Despite some reduction of income from American oil properties transferred to OPEC members, net investment income jumped, according to preliminary estimates, to about \$9 billion in 1974, some 70 percent above a year earlier. With these gains cushioning the effect of higher oil prices, the United States current-account balance, including Government grants, was expected to show a deficit of nearly \$5 billion in 1974, compared with the \$0.5 billion surplus of 1973.

The financing of large current-account deficits was clearly a major preoccupation of the authorities in most oil-importing countries in 1974. Such financing was provided through a multitude of channels. OPEC members provided loans not only to many less developed countries but also to industrial countries such as Britain, France, and Japan. Placements were made with various international and regional lending institutions. Substantial sums were also placed in negotiable securities, mainly short-term government securities in Britain, Germany, and the United States, as well as in direct investments.

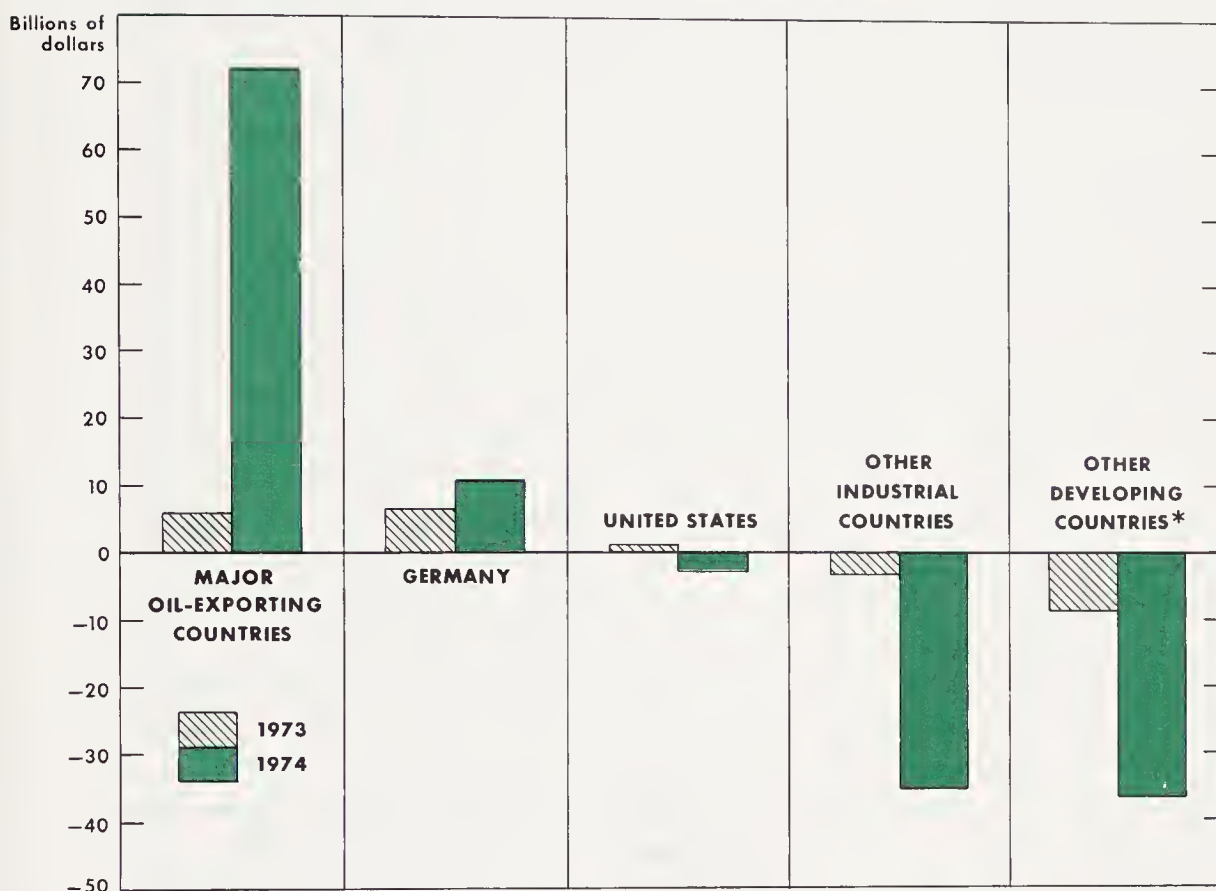
However, the most important channel in 1974 was the Euro-currency market. Banks operating in this market thus played a key role in intermediating between the surplus and deficit countries. Euro-currency placements by OPEC members were estimated at about one third of these countries' aggregate investable surpluses. For their part, oil-importing countries relied heavily for financing on the Euro-markets, borrowing a reported total of nearly \$27 billion in 1974, 39 percent more than in the previous year. Commercial banks in the United States also participated vigorously in the intermediation process, increasing their liabilities to foreigners by about \$16 billion in January-November and their claims on foreigners by \$17 billion.

With financing available to cover the oil-importing countries' current-account deficits, exchange rates fluctuated in response to shifts in official policy and especially to changes in interest rate differentials among the major financial centers. Shifts in speculative pressures also played a significant role. Reflecting such influences, the effective value of the dollar ranged during the year from

approximate parity with the central rates established under the Smithsonian agreement of December 1971 to an 8 percent depreciation. Fluctuations against the individual currencies in which traders actually operate were of course far wider. The swing in the dollar-Deutsche mark rate, for example, was no less than 18 percent against the central rate. The dollar's greatest strength was displayed in the early weeks of January, when the market judged that the United States could cope with the effects of OPEC policy better than other countries that were more dependent on imported oil. The dollar's largest depreciation was reached in mid-May after a 3½-month decline which began with the dropping of United States capital controls and which also witnessed the relaxation of foreign restraints on capital inflows. After wire services reported on May 14 that the German, Swiss, and United States central banks were prepared to counter excessive speculation against the dollar and, with short-term interest rates in the United States rising relative to those in major centers abroad, the dollar's effective exchange rate recovered most of the losses suffered earlier in the year. After early September, however, money rates in the United States began to decline relative to those abroad and some foreign countries took further steps to dismantle restrictions on capital inflows. Consequently, the dollar came under new pressure. At the year-end, its effective depreciation from the Smithsonian central rates amounted to 5.6 percent, compared with 3.4 percent at the beginning of the year.

The strains that arose from wide exchange rate swings, from the slowing of economic growth, and from the imbalance between the oil-exporting and oil-importing countries produced severe pressures on the international banking community. While many banks profited from exchange operations, some sustained losses that, in a few cases, led to insolvency. The closure of a German bank (Bankhaus I.D. Herstatt) toward the end of June had especially serious repercussions. Foreign exchange transactions were drastically curtailed immediately following the closure, with trading limited to names regarded in the market as having the highest quality. Subsequently, activity recovered, but small- and medium-size banks continued to experience trading difficulties both in the exchanges and in the Euro-dollar market as credit lines were tightened for all but the best names. Moreover, banks in numerous countries had to cope with rising liquidity needs as business plans, formulated in an inflationary environment, were undermined by the slowing of real economic activity. The banks also encountered difficulties in intermediating balances between the surplus and deficit countries. As the year progressed, the ratio of banks' short-

Chart 4. CURRENT-ACCOUNT BALANCES IN 1973 AND 1974



Current-account balances, estimated by the International Monetary Fund, include goods, services, and private transfers but exclude government grants. The estimates are adjusted to take account of various statistical asymmetries in oil trade and, for 1974, are preliminary.

* Nonoil primary-producing countries outside the communist bloc.

term liabilities to capital rose toward the limits set by prudent management. At the same time, bankers became increasingly concerned to avoid undue loan exposure to countries whose external debt was already large and whose balance-of-payments prospects were poor. One consequence of these various developments was that lending by Euro-banks slackened significantly in the second half of 1974 from the very rapid rate of the first half. Moreover, United States

commercial bank loans to foreigners, which had increased rapidly in February-August following the removal of capital controls, actually declined in September and then rose only modestly during the remainder of the year.

The need to avoid incipient banking difficulties was of major concern to the monetary authorities in all the industrial countries. In most of them, central bank surveillance over the exchange operations of commercial banks was tightened. In several countries, leading commercial banks established, with the encouragement and support of the monetary authorities, facilities designed to assist smaller institutions by relieving their liquidity difficulties. In Britain, the Bank of England acted to clarify and make explicit the responsibility that parent banks were customarily assumed to have toward consortium banks as well as toward subsidiaries. As the year progressed, increased efforts were made to maintain orderly conditions in the exchange markets through concerted intervention by the Federal Reserve, the Bundesbank, and several other central banks.

These various official efforts, important though they were in assuring the smooth functioning of international banking, could deal with only a part of the world's economic difficulties in 1974. With all but a few oil-importing countries suffering large current-account deficits and with unemployment rising, the pressure to adopt "beggar-thy-neighbor" policies was increasing. The agreement in May by the OECD countries to refrain, during the ensuing year, from imposing new restraints on trade and other current-account transactions was therefore welcome, as were the steps taken by six countries in September toward agreement to avoid the competitive extension of export credit. Even with the par value system suspended, International Monetary Fund (IMF) members were, of course, bound to refrain from exchange depreciation in order to gain competitive advantage. Beyond this, governments required a framework of reasonably stable exchange rates within which to cope with the formidable economic problems that lay ahead. The other side of the coin was, of course, the need for agreed guidelines by which appropriate changes in exchange rates could be made.

Increased recognition was given during 1974 to the need, not only for greater order in the exchange markets, but also for additional official facilities to finance payments imbalances. While the substantial existing facilities available among central banks and from the IMF still served important functions, they had been established to facilitate the financing of disequilibria that could be corrected in the short and medium term, i.e., more quickly than many feared the oil im-

balance could be reduced to manageable size. To deal with this new situation, a facility was established in June within the IMF to which oil-exporting countries, and the Netherlands, committed themselves to lend \$3.7 billion equivalent and from which various oil-importing countries borrowed \$2.1 billion during 1974. In view of the huge imbalance between oil-exporting and oil-importing countries, and of the reduced extent to which private markets could be expected to finance that imbalance, it became clear that, as initially constituted, the IMF oil facility went only a little way toward meeting the growing need for official financing. During the autumn, accordingly, various new proposals were made. The United Kingdom proposed that the existing oil facility within the IMF be modified and enlarged, while the United States advocated the establishment of a \$25 billion facility to assure the availability of financing to OECD countries that were unable to meet their needs elsewhere on reasonable terms.

Although a strengthening of international financial cooperation was clearly required, the more basic need was to reduce the payments imbalance between the oil-exporting countries and the rest of the world. A further substantial expansion of exports to the oil-producing countries was, of course, essential. There was also scope for the placement of OPEC balances in long-term portfolio and direct investment in the industrial countries. Beyond this, major efforts were required in energy conservation and the development of alternative energy supplies. Already progress was being made in this direction. Stimulated by high oil prices as well as by concern over the whole energy problem, intensive exploration during 1974 significantly increased proven reserves of oil outside the OPEC. Large coal reserves—particularly in the United States—remain to be exploited. The feasibility of generating energy by various advanced technologies deserves further intensive study. If energy use is reduced and additional supplies become available, both the volume and price of oil imports could be cut and the imbalances between oil-consuming and oil-producing countries could be reduced to manageable size.

PROBLEMS FOR MONETARY POLICY. At the year-end, the decline in real activity in the domestic economy had accelerated while the rate of inflation remained intolerably high. It was clear that in 1975 monetary policy would have to avoid adding to the weakness in the economy and to the strains in the credit system. At the same time, pressures for excessively stimulative policies had to be resisted. Such policies might strengthen the economy in the short run, but

in the longer run they would rekindle inflationary pressures and increase the ultimate costs of curbing inflation.

Given the deeply entrenched inflation, it seemed fairly clear that monetary policy would have to continue to pursue an underlying objective of maintaining, over the longer run, growth paths of the monetary aggregates consistent on average with reasonable price stability. Experience has made it quite clear that bringing inflation under control is an indispensable precondition of economic health. High rates of inflation have arbitrarily redistributed income and wealth. There is much evidence from many countries to suggest that, beyond a certain point, this process poses major risks of serious social and political, as well as economic, stress. Already, inflation has imposed significant strains on United States society and on a financial system geared to relatively stable prices. There have been bouts of disintermediation from financial institutions, swollen credit demands, and a general deterioration in the soundness of balance-sheet conditions. Moreover, variable and unpredictable rates of inflation may prompt borrowers and lenders to avoid long-term commitments, thereby impairing the functioning of the capital markets. This development, in turn, can tend to discourage investment in long-lived capital. In the context of current accounting conventions and tax laws, inflation has also discouraged real investment by causing profits to be overstated in real terms. Taxation of fictitious gains on capital assets and on inventory turnover has inflicted real capital losses on corporations.

Curbing inflation is a very important goal, but to achieve it will take time and will inevitably involve painful adjustments. There is need, therefore, for a range of auxiliary policies to facilitate progress toward the restoration of price stability and to relieve some of the strains in particularly sensitive sectors. As indicated earlier, labor market policies are needed, on the one hand, to lower the rate of unemployment compatible in the long run with price stability and, on the other hand, to reduce the hardship associated in the short run with the downturn in aggregate demand. There may be merit, too, in some new form of public institution designed primarily to provide capital to corporations suffering unusual financial stress or corporations engaged in programs of great importance to the solution of major national problems. Finally, policies to encourage price competition throughout the economy should be adopted, so that prices respond more quickly to policies designed to moderate aggregate demand. While these various proposals are in no way substitutes for monetary and fiscal actions, they can contribute significantly to the attainment of urgent national objectives.

THE BANK'S OPERATIONS IN 1974

Resolving the Problem of Franklin National Bank

For a period of five months beginning in early May, the problems of the Franklin National Bank occupied much of the attention of the senior officers and a number of the operating functions of this Bank. Under a program of credit assistance adopted early in May and continued through the ensuing months, the amounts of this Bank's advances to Franklin National rose from \$125 million on May 9 to \$1,723 million on October 8, the day that Franklin National was declared insolvent by the Comptroller of the Currency and this Bank's advance to Franklin was assumed by the Federal Deposit Insurance Corporation (FDIC).

Franklin National Bank, a subsidiary of Franklin New York Corporation, had experienced rapid growth during the 1950's and 1960's on Long Island, its principal area of operations. In the mid-1960's, Franklin National expanded into New York City by branching and merging. By year-end 1973, it had become the twentieth largest bank in the United States in terms of total assets, with total assets of about \$5 billion, more than 100 domestic branches, and overseas branches located in London and in Nassau, Bahamas. During this period of rapid growth, Franklin experienced some difficulties in maintaining sufficient capital to support its expansion and suffered a relatively high level of loan losses as a result of its liberal lending policies.

In late 1973 and early 1974, Franklin National's troubles were exacerbated by general conditions in the financial markets and increasingly critical management problems, and adverse rumors and speculation about the bank were circulating in the financial community. In part, Franklin National's mounting difficulties stemmed from its heavy reliance on short-term borrowings and large negotiable certificates of deposit to support aggressive lending and investment policies. Early in 1974 the bank's bond portfolio suffered substantial depreciation, as a decline in interest rates anticipated by the bank failed to materialize. At the same time, it became generally known in the financial community that Franklin National was dealing heavily in foreign exchange transactions and that its earnings, particularly if foreign exchange profits were

excluded from reported figures, were declining substantially. By early May 1974, Franklin National's name faced increasing and serious seller resistance in the Federal funds market as well as in the foreign exchange markets.

Franklin National's problems mounted rapidly during the week of May 6, 1974. The bank found it increasingly difficult to raise short-term funds and faced the prospect of a severe liquidity crisis. At meetings that week with senior officers of this Bank, Franklin National's officers disclosed the size of Franklin National's operating losses and the existence of irregularities in its foreign exchange transactions, which had just come to light and which would have serious adverse effects on the bank's earnings. It was learned that Franklin National's officers planned to recommend to their directors that they omit the next quarterly dividend.

On Friday, May 10, Franklin National issued a statement regarding the omission of the dividend. As a result, the price of the parent holding company's stock suffered a sharp decline during the remainder of trading on that day. By the close of business on Friday, Franklin National faced the prospect that its own dividend announcement, combined with news of foreign exchange losses and intensified market rumors about the bank's condition, would result during the next week in a virtual drying-up of money market sources of funds and a very real possibility of a run on the bank.

DISCOUNT WINDOW ASSISTANCE. During the week of May 6, this Bank had agreed to provide Franklin National with credit assistance to help it meet what was hoped would be a temporary liquidity crisis. By late Friday, May 10, and over the following weekend, it became apparent to the senior officers of this Bank that Franklin National was in serious danger of failure in the very near future if substantial Federal Reserve credit were not made available. The weekend of May 11-12 was a time of intense activity at this Bank. Senior officers met with Franklin National's management and attorneys and representatives of the Comptroller of the Currency and of the Securities and Exchange Commission (SEC). They also consulted by telephone with members of the Board of Governors of the Federal Reserve System in Washington, D.C., the Comptroller of the Currency, and representatives of a number of New York City commercial banks. By the opening of business on Monday, Franklin National had issued a statement announcing foreign exchange losses, the SEC had suspended trading in the stock of Franklin National's parent holding com-

pany, and Vice Chairman Mitchell of the Board of Governors had announced that the Federal Reserve System would “advance funds . . . as needed” to Franklin National through the discount window of this Bank “within the limits of the collateral that can be supplied” and that the Comptroller had furnished assurances that Franklin National was solvent.

In this Bank’s view, the failure of Franklin National at that time would have had serious adverse consequences for Franklin National’s depositors and creditors and the economy of Long Island. More importantly, given the general financial and economic situation at that time, such a failure would have jeopardized the stability of the United States banking system, with further serious repercussions for domestic and international financial markets in general. The decision to make substantial credit assistance available to Franklin National had two main purposes: first, to prevent the severe deterioration of confidence at home and abroad that would have resulted from an abrupt failure of the bank and, second, to provide time to permit Franklin National itself, or if necessary the bank regulatory authorities, to achieve a more permanent solution of the bank’s difficulties.

Beginning on Friday evening, May 10, this Bank undertook preparations for the anticipated increase in Franklin National’s borrowings at the discount window. The following Saturday and Sunday, about thirty-five members of this Bank’s staff—credit analysts, lawyers, and others—visited three of Franklin National’s offices to identify and review assets available as collateral. Some \$500 million of Franklin National’s customer notes were physically moved to this Bank’s vaults as collateral that weekend.

In subsequent weeks, as Franklin National’s need for Federal Reserve credit grew, the accumulation of collateral became increasingly complex. Although it was initially estimated that Franklin National had approximately \$2 billion in assets that could be used as collateral for advances by this Bank, many of these assets were represented by documents dispersed throughout Franklin National’s branch system, including a substantial amount at its London branch. Since the transfer of some of these documents to this Bank’s vaults was not practical, this Bank rented space at some of Franklin National’s branches so as to maintain legal possession and control of as much collateral as possible. To accept as collateral assets of Franklin National’s London branch, arrangements were made by members of this Bank’s Legal Department, with the assistance of British solicitors, for assets of the London branch to be held in London on this Bank’s behalf.

THE SEARCH FOR A RESOLUTION. In the following months, senior officers of this Bank met daily to review Franklin National's situation and to consider means of assisting the Comptroller of the Currency, the FDIC, and Franklin National itself to find intermediate and longer term solutions to the problem. Constant communication was maintained with the Board of Governors, the other bank supervisory agencies, Franklin National, and other commercial banks as they became involved in various aspects of the problem. A special task force of personnel drawn from the Loans and Credits, Bank Supervision, Foreign, and Legal functions of this Bank was formed to collect, review, and analyze data and to develop possible solutions and contingency plans. During June and July, attrition of Franklin National's deposits continued at a slow but steady pace and the size of its daily advances from this Bank continued to rise.

By the beginning of July, it had become apparent that any long-term resolution of the problem would require the participation of the FDIC in the form of financial assistance. The Chairman of the FDIC began a series of meetings with individual commercial banks to discuss the possibilities of some form of FDIC-assisted merger or acquisition of Franklin National's assets. As these meetings progressed, it began to appear likely that the eventual solution would involve the appointment of the FDIC as a receiver for Franklin National, with a sale and assumption of all or a part of Franklin National's assets and liabilities by another bank. Such a transaction would involve the receipt of bids from commercial banks interested in entering into such a purchase and assumption transaction. It became clear as discussions continued that, in order to ensure that the FDIC would receive an acceptable number of bids, it would be necessary to exclude from the liabilities to be assumed the advance of this Bank to Franklin National.

During August and September, the FDIC began a series of discussions with interested banks to develop a purchase and assumption arrangement, including provisions for FDIC financial assistance, on which such banks would be willing to submit bids. At the same time, this Bank and the FDIC developed an agreement under which, in the event of Franklin National's insolvency and a successful bidding arrangement, the FDIC would assume Franklin National's indebtedness to this Bank and this Bank would release to the FDIC its security interest in Franklin's assets.

FRANKLIN'S FOREIGN EXCHANGE CONTRACTS. In the process of develop-

ing a purchase and assumption arrangement, the FDIC learned that, as a group, banks interested in bidding under the arrangement were not willing to assume responsibility for the performance of Franklin National's foreign exchange contracts. At the same time, it appeared likely that, if Franklin National were to become insolvent, legal constraints might prevent the FDIC as receiver of Franklin National from honoring many of such foreign exchange contracts. There was thus a real danger that all or a substantial portion of Franklin National's foreign exchange contracts would be dishonored in the event of its insolvency, with serious consequences for market confidence. Earlier in the year, the failure of the Herstatt Bank in Germany to honor its current foreign exchange commitments on its closing had resulted in a shock to the foreign exchange markets and a weakening of the German mark. Similar damaging effects on the dollar could be expected if Franklin National's contracts were dishonored as a result of its insolvency.

Accordingly, it was concluded that the acquisition by this Bank of Franklin National's foreign exchange position would be in the best interests of the United States and the world economy as well as the foreign exchange markets. In September, after intensive effort by the Foreign Function of this Bank in evaluating Franklin National's foreign exchange position, this Bank and Franklin National entered into an agreement under which this Bank acquired Franklin National's foreign exchange position. Under the agreement, Franklin National paid to this Bank an amount estimated to cover the potential losses involved in the acquisition, including the book loss on Franklin National's total position and the risk that certain counterparties might fail to perform contracts as required. A substantial portion of this amount was returned to Franklin National on October 1, after all contracts had been confirmed to this Bank by the other parties to the contracts.

The acquisition of Franklin National's foreign exchange position by this Bank was greeted with relief by market participants in this country and overseas, and Franklin National's insolvency did not adversely affect the dollar.

THE FINAL STAGES. As September drew to a close, it became clear to the bank regulatory authorities that the appointment of the FDIC as receiver for Franklin National and the acquisition of its offices by a sound banking institution under an FDIC-assisted purchase and assumption arrangement offered the only practical hope of avoiding substantial losses to Franklin National's depositors

and current general creditors, and the disruption of the Long Island economy that would result from Franklin National's failure and liquidation.

By the first week in October the purchase and assumption arrangement developed by the FDIC was complete. A plan developed by Franklin National's management for the continued existence of the bank as an independent, Long Island-based institution was evaluated by the Federal bank supervisory agencies, each of which concluded that the plan had no reasonable prospects of success. Under the circumstances, this Bank determined that it would no longer be in the public interest for this Bank to continue its program of credit assistance to Franklin National, and the Comptroller of the Currency was so informed by letter dated October 7.

At 3 p.m. on October 8, the Comptroller of the Currency declared Franklin National insolvent and appointed the FDIC as receiver of the bank. The FDIC, having received bids from four New York City banks under its purchase and assumption arrangement, identified European-American Bank & Trust Company, a New York state-chartered nonmember insured bank owned by a consortium of six large European banks, as the highest bidder. By 4 p.m., a judge of the United States District Court for the Eastern District of New York had approved the purchase and assumption agreement between the FDIC as receiver for Franklin National and European-American, as well as a similar agreement between the FDIC and Bradford Trust Company relating to Franklin National's trust business. By that time also, this Bank and the FDIC had entered into an agreement providing for the assumption by the FDIC of this Bank's advance to Franklin National, with payment in full to be made within three years.

Upon the Comptroller's declaration of Franklin National's insolvency, the Accounting Department and many of the other operating departments of this Bank, following contingency plans developed in the preceding weeks, began the complex process of checking and posting to the Bank's books all the transactions between Franklin National and this Bank that had taken place that business day. This process was necessary to determine both the exact amount of Franklin National's reserve account as of 3 p.m. that day, which was one of the assets being purchased by European-American, and the exact amount of Franklin National's indebtedness to this Bank, which was being assumed by the FDIC. The calculations were not complete until about 5 a.m. on October 9, long after those involved in the more formal transactions of the day had left the Bank. On the morning of October 9, all of Franklin National's domestic offices opened under the name of European-American Bank & Trust Company.

Operational Highlights

STRENGTHENING PLANNING AND BUDGET CONTROLS. In a continuing effort to establish more effective management controls necessary in an inflationary environment to deal with the cost of this Bank's sharply increasing volume of operations and expanded responsibilities, work continued throughout last year on the installation of a new management system. The system more fully integrates the planning, budgeting, and cost control processes of the Bank. As part of this approach, each of the functional areas of the Bank headed by a vice president is recognized as a distinct responsibility center for the purposes of planning, budgeting, and controlling the quality and efficiency of operations. The new system—which involves such techniques as the setting of goals and measurable objectives, budgeting based on productivity targets as well as volume projections, and cost-benefit analysis of all new project proposals—is being installed by specially selected task forces made up of Bank personnel. It is expected that all areas of the Bank will be converted to this new system by mid-1975.

To support the new planning and budget control systems, the Bank is developing an enlarged and improved management information system to provide current and historical data on key volume, unit-cost, and productivity measures that will serve as the basis for formulating annual budgets and plans and for tracking progress and results against those budgets and plans.

Another important feature of the Bank's overall efforts to deal with rising operational demands is a program to improve both the productivity and the quality of the Bank's operations and services. The program, which will become increasingly active in coming months, will utilize the analytical framework provided by the newly installed planning and budget control system.

Even though these steps to strengthen the management systems of the Bank are not yet fully in place, their beneficial effects are already becoming apparent. Thus, despite a large increase in the work load of the Bank in 1974 and the rapid rate of inflation in the cost of labor and other resources, the Bank's total expenses net of reimbursements and recoveries rose less than 9 percent last year, largely because the Bank was able to operate with significantly fewer employees than had been expected.

BOOK-ENTRY PROGRESS. The joint Federal Reserve-United States Treasury book-entry program was expanded significantly during 1974, focusing mainly on Government and agency securities held by member banks, either as fiduciaries or as custodians for correspondent banks and other customers. By substituting computer bookkeeping entries for definitive securities, the book-entry procedure permits the issuance, servicing, custody, and redemption of eligible securities electronically at Federal Reserve Banks without the use of paper certificates. The program also simplifies and expedites transfers through this Bank's Government Securities Clearing Arrangement, and virtually eliminates the risk of loss or theft involved in the safekeeping and the delivery of physical securities.

Second District banks converted into book-entry form increasing amounts of securities held for the account of customers. Two New York City banks, one of which should complete its book-entry conversion early in 1975, added about \$3.6 billion of securities to the program, retiring some 77,000 pieces of paper. At the year-end, \$201.4 billion, or 71.6 percent of marketable United States public debt, was in book-entry form, compared with \$176.6 billion or 65.4 percent a year earlier. In July, the initial securities of the Federal Financing Bank were marketed and were immediately eligible for book entry. At the year-end, almost \$0.9 billion of the \$1.5 billion of these securities outstanding was in book-entry form.

Substantial progress was made toward qualifying all Federal agency securities for book-entry procedures in May, when Federal National Mortgage Association securities became eligible. Other agencies whose securities have been converted include the Banks for Cooperatives, Farmers Home Administration, Federal Home Loan Banks, Federal Intermediate Credit Banks, Federal Land Banks, and the United States Postal Service. Nationally, about \$22.3 billion of agency securities was in book entry at the year-end, or about 32 percent of the estimated \$70 billion eligible for conversion.

TREASURY OFFERINGS ATTRACTED THOUSANDS OF INDIVIDUALS. Record interest rates on Treasury securities during 1974 attracted thousands of individual investors to the Bank and generated over 100,000 telephone inquiries regarding purchasing procedures. About 60,000 Treasury bill tenders from individuals were processed, more than double the number submitted in

1973. Similarly, subscriptions from individuals for Treasury notes and bonds totaled over 14,000, nearly triple 1973's total of 5,000.

FOREIGN ACCOUNT INVESTMENT ACTIVITY INCREASED. Shifts in international flows of funds, resulting partly from increased payments to oil-exporting nations, led to a further increase in investment activity conducted by the New York Reserve Bank for foreign official institutions. The open market Trading Desk bought and sold \$85 billion of Government and agency issues outright for foreign accounts in 1974, a gain of about 15 percent over 1973. In addition, this Bank executed a sizable volume of short-term repurchase agreements for foreign accounts beginning in August.

MONITORING FOREIGN EXCHANGE MARKETS. Two new units were established—one in the International Research Department and the other in the Foreign Department—in response to 1973 legislation amending the Par Value Modification Act and requiring United States banks and nonbank concerns and their foreign entities to report to the Treasury their foreign exchange positions. The Federal Reserve collects these reports on behalf of the Treasury. These reports, along with other information, will assist in the evaluation of foreign exchange and Euro-currency market developments.

NEW BUILDING AND ENERGY CONSERVATION. Energy conservation was a prime focus during 1974, in both the Liberty Street facility and in the new building plans, which have progressed through the design development stage. The President's call for energy conservation in late 1973 was met with a program that reduced the main building's fuel consumption 20 percent and electricity purchases 10 percent. In addition, plans for the new building were revised to incorporate exterior wall construction and air conditioning systems that will reduce energy consumption substantially. These changes will increase original construction costs, but the savings provided by energy conservation are expected to recover the additional investment in about a decade. All significant negotiations with New York City regarding the new building site were completed during the year, and Carl A. Morse, Inc., was engaged as construc-

tion consultant. The firm will work closely with the Bank's architects—Kevin Roche John Dinkeloo and Associates—during construction.

FOOD-COUPON-PROCESSING FACILITY IN PUERTO RICO. Plans for a new food-coupon-processing facility in San Juan, Puerto Rico, were developed in conjunction with the implementation by the Department of Agriculture of the Food Stamp Program in the Commonwealth of Puerto Rico and in the Virgin Islands in the second half of 1974. This Bank, as fiscal agent of the United States, acting on behalf of the Department of Agriculture, has requested the Government Development Bank for Puerto Rico to act as agent of this Bank for the performance of certain services in connection with the Food Stamp Program. These include the receipt and processing of remittances from the sale of food coupons, the receipt of redeemed coupons from commercial banks in Puerto Rico and in the Virgin Islands and the processing of payments to such banks, and the verification and destruction of such coupons in Puerto Rico. Until the San Juan facility is completed in early 1975, the Government Development Bank for Puerto Rico will airfreight redeemed food coupons to the Buffalo Branch for verification and destruction.

Financial Statements

STATEMENT OF EARNINGS AND EXPENSES FOR THE CALENDAR YEARS 1974 AND 1973 (In thousands of dollars)

	1974	1973
Total current earnings	1,686,670	1,347,807
Net expenses	118,227	108,848
Current net earnings	1,568,443	1,238,959
Additions to current net earnings	1,252	503
Deductions from current net earnings:		
Loss on sales of United States Government securities and Federal agency obligations (net)	10,575	9,281
Loss on foreign exchange transactions (net)	8,661	12,376
All other	1,599	60
Total deductions	20,835	21,717
Net deductions	19,583	21,214
Net earnings available for distribution	1,548,860	1,217,745
Dividends paid	13,628	12,550
Payments to United States Treasury (interest on Federal Reserve notes)	1,515,543	1,196,836
Transferred to surplus	19,689	8,359
SURPLUS ACCOUNT		
Surplus—beginning of year	214,963	206,604
Transferred from net earnings for year	19,689	8,359
Surplus—end of year	234,652	214,963

STATEMENT OF CONDITION

In thousands of dollars

Assets	DEC. 31, 1974	DEC. 31, 1973
Gold certificate account	3,413,162	3,231,124
Special Drawing Rights certificate account	93,000	93,000
Federal Reserve notes of other Banks	232,852	197,838
Other cash	14,251	19,012
Total	3,753,265	3,540,974
Advances	90,750	485,105
Acceptances:		
Bought outright	578,949	68,014
Held under repurchase agreements	420,271	0
United States Government securities:		
Bought outright*	17,783,692	19,313,746
Held under repurchase agreements	443,350	58,000
Federal agency obligations:		
Bought outright	1,044,519	476,947
Held under repurchase agreements	510,500	42,000
Total loans and securities	20,872,031	20,443,812
Other assets:		
Cash items in process of collection	1,456,276	2,575,287
Bank premises	11,737	10,067
All other†	2,028,849‡	207,995
Total other assets	3,496,862	2,793,349
Total Assets	28,122,158	26,778,135

* Includes securities loaned—fully secured by United States Government securities pledged with the Bank

154,600

162,950

† Includes assets denominated in foreign currencies.

‡ Includes indebtedness of \$1,723,472,055 assumed by the Federal Deposit Insurance Corporation in connection with the closing of the Franklin National Bank.

STATEMENT OF CONDITION

In thousands of dollars

Liabilities	DEC. 31, 1974	DEC. 31, 1973
Federal Reserve notes	17,979,729	16,081,665
Deposits:		
Member bank reserve accounts	6,139,480	7,780,246
United States Treasury—general account	1,080,151	394,348
Foreign★	201,978	58,635
Other	812,646	673,840
Total deposits	8,234,255	8,907,069
Other liabilities:		
Deferred availability cash items	1,157,281	1,118,004
All other	281,589	241,471
Total other liabilities	1,438,870	1,359,475
Total Liabilities	27,652,854	26,348,209
Capital Accounts		
Capital paid in	234,652	214,963
Surplus	234,652	214,963
Total Capital Accounts	469,304	429,926
Total Liabilities and Capital Accounts	28,122,158	26,778,135
Contingent liability on acceptances purchased for foreign correspondents†	248,632	151,662

★ After deducting participations of other Federal Reserve Banks amounting to

216,050 192,140

† After deducting participations of other Federal Reserve Benks amounting to

732,186 429,433

Changes in Directors and Senior Officers

CHANGES IN DIRECTORS. In December 1974, member banks in Group 2 elected Stuart McCarty a Class A director and reelected William S. Sneath a Class B director, each for a three-year term beginning January 1, 1975. Mr. McCarty is President of First-City National Bank of Binghamton, Binghamton, N.Y. Mr. Sneath, President of Union Carbide Corporation, New York, N.Y., has been a Class B director since August 15, 1973.

Also in December, the Board of Governors of the Federal Reserve System reappointed Roswell L. Gilpatric a Class C director for the three-year term beginning January 1, 1975, and redesignated him as *Chairman* of the board of directors and *Federal Reserve Agent* for the year 1975. Mr. Gilpatric, a partner in the New York law firm of Cravath, Swaine & Moore, has been serving as a Class C director since January 1969; he served as *Deputy Chairman* in 1971 and as *Chairman* and *Federal Reserve Agent* in 1972, 1973, and 1974. At the same time, the Board of Governors reappointed Frank R. Milliken as *Deputy Chairman* for the year 1975. Mr. Milliken, President of Kennecott Copper Corporation, New York, N.Y., has been serving as a Class C director, and as *Deputy Chairman*, since January 1973. He served as a Class B director in 1972.

Buffalo Branch. In December, the Board of Governors appointed Paul A. Miller a director of the Buffalo Branch for a three-year term beginning January 1, 1975. Dr. Miller is President of the Rochester Institute of Technology, Rochester, N.Y. On the Branch board, he succeeded Norman F. Beach, Vice President, Eastman Kodak Company, Rochester, N.Y., who had been a director of the Branch since January 1968, serving as *Chairman* of the Branch board in 1971 and 1974. Also in December, the board of directors of this Bank appointed Stephen T. Christian a director of the Buffalo Branch for a three-year term beginning January 1, 1975. Mr. Christian is President of Marine Midland Bank-Chautauqua, National Association, Jamestown, N.Y. On the Branch board, he succeeded Theodore M. McClure, President of The Citizens National Bank and Trust Company, Wellsville, N.Y., who had been a director of the Branch since January 1972. At the same time, the board of directors of this Bank designated Donald R. Nesbitt as *Chairman* of the Branch board for the year 1975. Mr. Nesbitt, who is the owner and operator of Silver Creek Farms, Albion, N.Y., has been a director of the Branch since January 1973.

CHANGES IN SENIOR OFFICERS. The following changes in the official staff, at the level of Vice President and above, have been made since January 1974:

The assignment of David E. Bodner, Vice President, to the Foreign Function was terminated, effective February 1, 1974, in view of his resignation, effective April 1, 1974, to accept a position as Senior Vice President at Chemical Bank, New York, N.Y. Mr. Bodner joined the Bank's staff in 1959 and became an officer in 1965. Between February 1 and April 1, 1974, he was assigned responsibility for special studies for the President and First Vice President. Mr. Bodner also resigned as Deputy Special Manager of the System Open Market Account, effective February 1, 1974.

H. David Willey, Vice President, was assigned to the Foreign Function, effective February 22, 1974, with supervisory responsibility for the operations of the function under Charles A. Coombs, Senior Vice President. Mr. Willey's assignment as the officer in charge of the Loans and Credits Function was continued.

Scott E. Pardee, formerly Assistant Vice President, was appointed Vice President, effective February 22, 1974, and assigned to the Foreign Function.

Thomas O. Waage, Senior Vice President, was assigned senior management responsibility for the Government Bond and Safekeeping of Securities Function on September 6, 1974. Mr. Waage also maintained senior management responsibility for the Cash and Collection, Check Processing, and Public Information functions.

Frederick C. Schadrack, Jr., formerly Adviser, was appointed Vice President on September 6, 1974 and assigned to the Bank Supervision and Relations Function, with supervisory responsibility for the operations of the Banking Studies, Domestic Banking Applications, and Foreign Banking Applications Departments under Fred W. Piderit, Jr., Vice President. In addition, Mr. Schadrack was assigned supervisory responsibility for the operations of the Bank Analysis Department under Mr. Piderit on January 2, 1975.

Chester B. Feldberg was appointed Vice President on January 2, 1975 and assigned to the Loans and Credits Function, with supervisory responsibility for the operations of the function under Mr. Willey. Mr. Feldberg had returned to the Bank as Adviser, effective September 1, 1974, following his resignation as Secretary of the Board of Governors of the Federal Reserve System. He had formerly served as Secretary of this Bank from 1969 to 1973.

George Garvy, Vice President and Senior Adviser, retired on early retire-

ment effective February 1, 1975, after completing thirty-two years of service with the Bank. Mr. Garvy joined the Bank's staff in 1943 and became an officer in 1953.

MEMBER OF FEDERAL ADVISORY COUNCIL—1975. The board of directors of this Bank selected Ellmore C. Patterson, Chairman of the Board of Morgan Guaranty Trust Company of New York, New York, N.Y., to serve during 1975 as the member of the Federal Advisory Council representing the Second Federal Reserve District. On the Council, Mr. Patterson succeeded Gabriel Hauge, Chairman of the Board of Manufacturers Hanover Trust Company, New York, N.Y., who was this District's member in 1973 and 1974.

Directors of the Federal Reserve Bank of New York

DIRECTORS

	<i>Term expires Dec. 31</i>	<i>Class</i>	<i>Group</i>
DAVID ROCKEFELLER Chairman of the Board, The Chase Manhattan Bank (National Association), New York, N.Y.	1976	A	1
STUART MCCARTY President, First-City National Bank of Binghamton, Binghamton, N.Y.	1977	A	2
NEWMAN E. WAIT, JR. President, The Adirondack Trust Company, Saratoga Springs, N.Y.	1975	A	3
MAURICE F. GRANVILLE Chairman of the Board, Texaco Inc., New York, N.Y.	1976	B	1
WILLIAM S. SNEATH President, Union Carbide Corporation, New York, N.Y.	1977	B	2
JACK B. JACKSON President, J. C. Penney Company, Inc., New York, N.Y.	1975	B	3
ROSWELL L. GILPATRIC, <i>Chairman, and Federal Reserve Agent</i> Partner, Cravath, Swaine & Moore, Attorneys, New York, N.Y.	1977	C	
FRANK R. MILLIKEN, <i>Deputy Chairman</i> President, Kennecott Copper Corporation, New York, N.Y.	1975	C	
ALAN PIFER President, Carnegie Corporation of New York, New York, N.Y.	1976	C	

DIRECTORS—BUFFALO BRANCH

DONALD R. NESBITT, <i>Chairman</i> Owner and operator, Silver Creek Farms, Albion, N.Y.	1975
CLAUDE F. SHUCHTER Chairman of the Board, Manufacturers and Traders Trust Company, Buffalo, N.Y.	1975
J. WALLACE ELY Chairman of the Board, Security New York State Corporation, Rochester, N. Y.	1976
DANIEL G. RANSOM President, The Wm. Hengerer Co., Buffalo, N.Y.	1976
RUPERT WARREN Former President, Trico Products Corporation, Buffalo, N.Y.	1976
PAUL A. MILLER President, Rochester Institute of Technology, Rochester, N.Y.	1977
STEPHEN T. CHRISTIAN President, Marine Midland Bank-Chautauqua, National Association, Jamestown, N.Y.	1977

MEMBER OF FEDERAL ADVISORY COUNCIL—1975

ELLMORE C. PATTERSON Chairman of the Board, Morgan Guaranty Trust Company of New York, New York, N.Y.	1975
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Officers of the Federal Reserve Bank of New York

ALFRED HAYES, *President*

RICHARD A. DEBS, *First Vice President*

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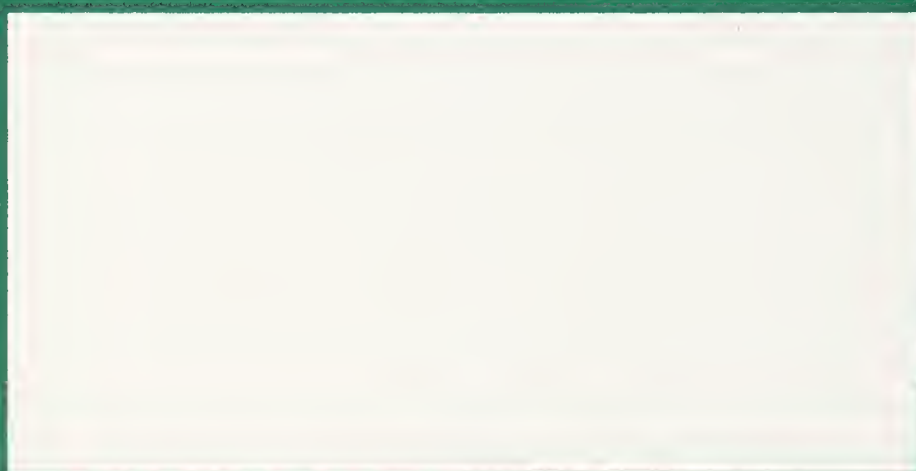
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